

**UNITES STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA**

In Re: RELS Manufacturing Corp.,

Chapter 11

Debtor.

BKY 04-42532-RJK

**PAYROLL CONTROL SYSTEMS' OBJECTIONS TO PROPOSED
DISCLOSURE STATEMENT OF DEBTOR**

Diversified Industries, Inc., d/b/a Payroll Control Systems (hereinafter "PCS"), by its undersigned attorney, hereby objects to the adequacy of the information in the Proposed Disclosure Statement and Plan, both dated September 30, 2004, filed by the debtor in possession in the case above-captioned. In furtherance of its objection, PCS states as follows:

1. This matter is set for hearing at 10:30 a.m. on November 3, 2004 before the Honorable Robert J. Kressel, United States Bankruptcy Judge, Courtroom 8 West, United States Courthouse, 300 South Fourth Street, Minneapolis, Minnesota 55415.
2. The proposed disclosure statement and plan do not contain adequate information because it incorrectly classifies the claim of PCS.
 - a. PCS' claim arises out of payroll withholding taxes paid by PCS on behalf of debtor.
 - b. PCS' claim totals \$4,787.85. Of that amount, \$2,492.86 is pre-petition withholding tax for wages earned prior to the commencement of this Chapter 11 proceeding, and therefore is

subject to eighth priority pursuant to 11 U.S.C. §507(a)(8)(C) and (D).

- c. The remaining \$2,294.99 represents withholding taxes for wages earned post-petition, and therefore is entitled to first administrative priority under 11 U.S.C. §503(b)(1)(B).

WHEREFORE, Payroll Control Systems hereby objects to the adequacy of the information contained in the debtor's proposed disclosure statement and plan and submits that the proposed disclosure statement should not be approved unless the forgoing inaccuracies are remedied.

Dated: October 27, 2004.

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ATTORNEY FOR PAYROLL CONTROL
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**UNITES STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA**

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PAYROLL CONTROL SYSTEMS' MEMORANDUM OF LAW IN SUPPORT OF
ITS OBJECTIONS TO PROPOSED DISCLOSURE STATEMENT OF DEBTOR

Diversified Industries, Inc., d/b/a Payroll Control Systems ("PCS") hereby makes the following Memorandum of Law in support of its Objection to Proposed Disclosure Statement of RELS Manufacturing Corporation (hereinafter "Debtor" or "RELS").

The primary purpose of a disclosure statement is to give creditors information necessary to decide whether to accept the plan. In Re Monnier Bros. 755 F.2d 1336,1342 (8th Cir. 1985).

A disclosure statement must provide "adequate information" as defined in 11 U.S.C. §1125(a).

PCS is engaged in business as a payroll service provider. PCS provided payroll services to debtor. On March 24, 2004, PCS paid Debtor's payroll withholding taxes in the amount of \$2,492.86. These withholding taxes were for wages earned before March 24, 2004 (the date of the filing of Debtor's petition). Thus, these are pre-petition taxes. Pursuant to its agreement with Debtor, upon payment of the withholding taxes by PCS, PCS initiated an electronic debit to RELS' bank account in the amount of withholding tax actually paid by PCS. However, payment was stopped on this debit transaction by RELS.

On March 31, 2004, PCS paid RELS' withholding taxes in the amount of \$2,294.99. These withholding taxes were for wages earned in whole or in part following the date of Debtor's Petition (i.e., these are for taxes incurred post-petition). As with the prior payment, upon its payment of RELS' withholding tax, PCS initiated an electronic debit to Debtor's account. This debit was denied due to non-sufficient funds ("NSF").

I. Pre-Petition Wage Taxes

Employee withholding taxes are entitled to eighth priority under 11 U.S.C.

§507(a)(8):

"Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for—

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

(D) an employment tax on a wage, salary, or commission of a kind specified in paragraph (3) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition."

Since the tax paid by PCS on behalf of RELS was "required to be collected" and "withheld" and for which RELS is "liable," the portion of PCS' claim relating to withholding tax which accrued pre-petition is entitled to eighth priority and not to the general unsecured claim status as alleged by RELS in the proposed disclosure statement.

Although §507(a)(8) relates to governmental entities, PCS is entitled to "step into the shoes" of the tax authority as an assignee, as evidenced by the holding in In Re Missionary Baptist Foundation of America, Inc. where a supermarket that cashed the payroll checks of the debtor's employees (which were dishonored due to non-sufficient funds) was allowed to claim the same priority as the employees would have been, had

those checks been dishonored after deposit into the employees' individual accounts. In granting priority to the check cashing supermarket, the Court affirmed the trial court which concluded that the store which had cashed payroll checks for debtors' employees was an assignee of the employees' claims, and not subrogated to their claims, and thus was entitled to assert the employees' wage priority. 667 F.2d 1244 (5th Cir. 1982).

Moreover, the idea of allowing an assignee to recover "in the shoes" of a tax authority was supported in In Re Formisano, where the good faith purchaser of Debtor's real property at a tax sale was entitled to collect the taxes due from Debtor as an administrative expense under 11 U.S.C. §503(b), even though the purchaser was a natural person and not a taxing authority. 148 B.R. 217, 225-26 (Bky. D. N.J. 1992).

Thus, because PCS paid the tax on behalf of RELS pursuant to the agreement between them, PCS is entitled to eighth priority on the pre-petition withholding taxes in the amount of \$2,492.86, since that tax payment was for wages earned before Debtor filed its petition. Therefore, the proposed disclosure statement is erroneous where it lumps PCS' claim into the general, unsecured, non-priority claims.

II. Post-Petition Wage Taxes

PCS also paid taxes on wages which were earned in whole or in part following the filing of Debtor's petition on March 24, 2004. The payment was made by PCS on March 31, 2004, which was six days following the filing of the petition. These taxes are entitled to first priority as an administrative expense as "any tax incurred by the estate, except a tax of a kind specified in section 507(a)(8) of this title." 11 U.S.C. § 503(b)(1)(B). The §507(a)(8) taxes referred to therein are pre-petition taxes. Thus the post-petition taxes are "incurred by the estate" and are NOT the kind specified in

§507(a)(8), thus satisfying the two-prong test articulated by the Court in In Re L.J. O'Neill Shoe Co., 64 F.3d 1146, 1149 (8th Cir. 1995), because the post-petition taxes were “incurred” after the filing of the petition and are not dealt with in §507(a)(8), since that section refers to pre-petition taxes only. Consequently, \$2,294.99 of PCS’ claim is entitled to first priority as an administrative expense.

III. Conclusion

PCS objects to Debtor’s proposed disclosure statement on the basis that it is erroneous and fails to properly classify PCS’ claim in this case. The proper allocation is as follows:

- \$2,492.86 of PCS’ claim receives eighth priority under 11 U.S.C. §507(a)(8); and
- \$2,295.99 of PCS’ claim receives first priority as an administrative expense under 11 U.S.C. §503(b)(1)(B).

Thus, based on the foregoing, PCS respectfully requests that the Court not approve Debtor’s proposed disclosure statement, until PCS’ claim is properly classified, so that PCS may have the necessary information to decide whether nor not to accept the plan.

Dated: October 27, 2004.

Respectfully submitted,

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ORDER DENYING APPROVAL OF PROPOSED DISCLOSURE STATEMENT

At Minneapolis, Minnesota, this ____ day of _____, 2004.

This matter came duly on for hearing on the adequacy of the September 30, 2004 Proposed Disclosure Statement filed by the Debtor in the above-captioned case.

Paul W. Chamberlain, Chamberlain Law Firm, appeared on behalf of Diversified Industries, Inc. d/b/a Payroll Control Systems. Other appearances were noted on the record.

The Court made its findings of fact and conclusions of law on the record pursuant to F.R.C.P. 52 and F. R. Bkr. P. 7052.

IT IS HEREBY ORDERED:

That approval of the Proposed Disclosure Statement is DENIED.

Hon. Robert J. Kressel
United States Bankruptcy Judge

CERTIFICATE OF SERVICE

In Re:)
)
RELS Manufacturing Corporation)
 Debtor(s).)
)
)
)

Bankruptcy No. 04-42532
Chapter 11 Case

I, Catherine M. Schmidt, declare under penalty of perjury that on October 27, 2004, I served a copy of the foregoing Payroll Control Systems' Objections to Proposed Disclosure Statement of Debtor by fax to each person named below:

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DATED: __October 27, 2004 BY: ___/e/ Catherine M. Schmidt _____